

REPORT OF THE AUDITOR-GENERAL TO THE NORTHERN CAPE PROVINCIAL LEGISLATURE AND THE COUNCIL ON THE HANTAM LOCAL MUNICIPALITY

REPORT ON THE FINANCIAL STATEMENTS

Introduction

1. I have audited the financial statements of the Hantam Local Municipality set out on pages ... to ..., which comprise the statement of financial position as at 30 June 2012, the statement of financial performance, statement of changes in equity and cash flow statement for the year then ended, and the notes, comprising a summary of significant accounting policies and other explanatory information.

Accounting officer's responsibility for the financial statements

2. The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with South African Standards of Generally Recognised Accounting Practice (SA Standards of GRAP) and the requirements of the Municipal Finance Management Act of South Africa, 2003 (Act No. 56 of 2003) (MFMA) and the Division of Revenue Act of South Africa, 2010 (Act No. 1 of 2010, as amended) (DoRA), and for such internal control as the accounting officer determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor-General's responsibility

3. My responsibility is to express an opinion on these financial statements based on my audit. I conducted my audit in accordance with the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA), the general notice issued in terms thereof and International Standards on Auditing. Those standards require that I comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.
4. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.
5. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my qualified audit opinion.

Basis for qualified opinion

Property, plant and equipment

6. The initial estimate for the landfill site arising from the rehabilitation provision was not calculated from the establishment date of the landfill site, as required by paragraph 25 of SA Standards of GRAP, GRAP 17, *Property, Plant and Equipment*. This resulted in the overstatement of property, plant and equipment by R1 793 068, the overstatement of the accumulated depreciation by R137 369, and the overstatement of the accumulated surplus by R1 655 699.

Investment property

7. Investment property of the municipality to the value of R2 750 000 was not recognised in the financial statements, as required by SA Standards of GRAP, GRAP 16, *Investment Property*, resulting in investment property and the accumulated surplus being understated by R2 750 000 (2011: R2 964 300). In addition, investment properties not included in the asset register were identified of which I could not determine the value.
8. The municipality did not measure investment property at fair value in accordance with SA Standards of GRAP, GRAP 16, *Investment Property*. Consequently, investment property and the accumulated surplus are both overstated by R5 026 915.
9. I did not determine the correct carrying amount of investment property, as it was impracticable to do so in the absence of sufficient appropriate audit evidence. Consequently, I was unable to determine the extent of the adjustment necessary to disclose investment property.

Irregular expenditure

10. The municipality did not include particulars of irregular expenditure in the notes to the financial statements, as required by section 125 of the MFMA. Note 34.2 to the financial statements for irregular expenditure was submitted with zero balances. The municipality made payments in contravention of the supply chain management (SCM) requirements that were not included in irregular expenditure, resulting in irregular expenditure being understated by R771 418 (2011: R1 221 063).
11. I did not determine the full extent of irregular expenditure, as it was impracticable to do so in the absence of a system to detect and record irregular expenditure. Consequently, I was unable to determine whether any further adjustments were necessary to the amount disclosed for irregular expenditure.

Receivables from exchange and non-exchange transactions

12. In terms of IAS 39, the municipality must assess at each reporting date whether a financial asset or group of financial assets is impaired. The municipality did not recognise a provision for an impairment loss in accordance with the South African Statement of Generally Accepted Accounting Practice, IAS 39, *Financial Instruments: Recognition and Measurement*, as the basis for the calculation of the impairment loss did not comply with the stipulations of IAS 39. Receivables from exchange transactions with a net carrying amount of R21 313 688 and receivables from non-exchange transactions with a net carrying amount of R7 014 587 are included in notes 15 and 16 to the financial statements without a proper assessment having been made of the recoverability of these debtors. I have not determined the correct carrying amount of receivables, as it was impracticable to do so. Consequently, I was unable to determine whether any adjustments were necessary to the amount disclosed for receivables from exchange and non-exchange transactions.

Accounts payable

13. Sufficient appropriate audit evidence for funds received from third parties disclosed as other creditors in note 6 to the financial statements amounting to R549 919 could not be provided for audit purposes. The entity's records did not permit the performance of alternative procedures. Consequently, I was unable to determine whether any adjustment to trade payables was necessary.

Qualified opinion

14. In my opinion, except for the possible effects of the matters described in the basis for qualified opinion paragraphs, the financial statements present fairly, in all material respects, the financial position of the Hantam Local Municipality as at 30 June 2012 and its financial performance and cash flows for the year then ended, in accordance with SA Standards of GRAP and the requirements of the MFMA and DoRA.

Emphasis of matter

15. I draw attention to the matter below. My opinion is not modified in respect of this matter.

Material losses and impairments

16. As disclosed in note 15 to the financial statements, a significant provision for the impairment of receivables from exchange transactions was created, which constituted 72% of the total receivables from exchange transactions balance.
17. As disclosed in note 16 to the financial statements, a significant provision for the impairment of receivables from non-exchange transactions was created, which constituted 58% of the total receivables from non-exchange transactions balance.
18. As disclosed in note 45 to the financial statements, material losses of R1 633 230 and R2 888 470 were incurred as a result of the distribution of water and electricity, respectively.

Additional matters

19. I draw attention to the matters below. My opinion is not modified in respect of these matters:

Material inconsistencies in other information included in the annual report

20. As the 2011-12 annual report had not been received at the date of this report, a conclusion could not be drawn on the consistency between the financial statements and the audit report with other information included in the annual report.

Unaudited supplementary schedules

21. The supplementary information set out in appendices A to F does not form part of the financial statements and is presented as additional information. I have not audited these schedules and, accordingly, I do not express an opinion thereon.

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

22. In accordance with the PAA and the general notice issued in terms thereof, I report the following findings relevant to performance against predetermined objectives, compliance with laws and regulations and internal control, but not for the purpose of expressing an opinion.

Predetermined objectives

23. I performed procedures to obtain evidence about the usefulness and reliability of the information in the annual performance report as set out on pages ... to ... of the annual report.
24. The reported performance against predetermined objectives was evaluated against the overall criteria of usefulness and reliability. The usefulness of information in the annual performance report relates to whether it is presented in accordance with the National Treasury's annual reporting principles and whether the reported performance is consistent with the planned objectives. The usefulness of information further relates to whether indicators and targets are measurable (i.e. well defined, verifiable, specific, measurable and time bound) and relevant as required by the National Treasury's *Framework for managing programme performance information* (FMPPI).
25. The reliability of the information in respect of the selected programmes is assessed to determine whether it adequately reflects the facts (i.e. whether it is valid, accurate and complete).
26. The material findings are as follows:

Usefulness of information

Presentation

27. Section 46 of the Municipal Systems Act of South Africa, 2000 (Act No. 32 of 2000) (MSA) requires the disclosure of measures taken to improve performance in the annual performance report where planned targets were not achieved. Adequate and reliable corroborating evidence

could not be provided for 33% of the measures taken to improve performance as disclosed in the annual performance report. The municipality's records did not permit the application of alternative audit procedures. Consequently, I did not obtain sufficient appropriate audit evidence to satisfy myself as to the validity, accuracy and completeness of the measures taken to improve performance.

Measurability

28. The FMPPI requires that performance targets be measurable. The required performance could not be measured for a total of 39% of the targets relevant to municipal transformation and organizational development, basic service delivery as well as municipal financial viability and management. This was due to the fact that management was aware of the requirements of the FMPPI but had not received the necessary training to enable application of the principles.
29. The FMPPI requires that the time period or deadline for delivery be specified. A total of 20% of the targets relevant to basic service delivery as well as municipal financial viability and management were not time bound in specifying a time period or deadline for delivery. This was due to the fact that management was aware of the requirements of the FMPPI but had not received the necessary training to enable application of the principles.

Reliability of selected development priorities in the annual performance report

Validity

30. The FMPPI requires that processes and systems that produce the indicator be verifiable. I was unable to obtain all the information and explanations I considered necessary to satisfy myself as to the validity of the actual reported performance relevant to 38% of the basic service delivery as well as municipal financial viability and management indicators. This was due to limitations placed on the scope of my work due to the targets set not being measurable. The municipality's records did also not permit the application of alternative audit procedures.

Accuracy

31. The FMPPI requires that the indicator be accurate enough for its intended use and respond to changes in the level of performance. I was unable to obtain all the information and explanations I considered necessary to satisfy myself as to the accuracy of the actual reported performance relevant to 38% of the basic service delivery as well as municipal financial viability and management indicators. This was due to limitations placed on the scope of my work due to the targets set not being measurable. The municipality's records did also not permit the application of alternative audit procedures.

Completeness

32. The FMPPI requires that documentation addressing the systems and processes for identifying, collecting, collating, verifying and storing information be properly maintained. I was unable to obtain all the information and explanations I considered necessary to satisfy myself as to the completeness of the actual reported performance relevant to 38% of the basic service delivery as well as municipal financial viability and management indicators. This was due to limitations placed on the scope of my work due to the targets set not being measurable. The municipality's records did also not permit the application of alternative audit procedures.

Compliance with laws and regulations

33. I performed procedures to obtain evidence that the entity has complied with applicable laws and regulations regarding financial matters, financial management and other related matters. My findings on material non-compliance with specific matters in key applicable laws and regulations as set out in the general notice issued in terms of the PAA are as follows:

Strategic planning and performance management

34. The municipality did not establish mechanisms to monitor and review its performance management system, as required by section 40 of the MSA.

35. The municipality did not set measurable performance targets with regard to each development priority and objective.
36. The municipality did not monitor performance with regard to each development priority and objective and against the key performance indicators and targets set.
37. The municipality did not take steps to improve performance with regard to those development priorities and objectives where performance targets were not met, as required by section 41 of the MSA.

Annual financial statements, performance report and annual report

38. The accounting officer did not submit the financial statements for auditing within two months after the end of the financial year, as required by section 126(1)(a) of the MFMA.
39. The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122 of the MFMA. Material misstatements of liabilities, revenue and disclosure items identified by the auditors in the submitted financial statements were subsequently corrected, but the uncorrected material misstatements resulted in the financial statements receiving a qualified audit opinion.

Audit committee

The minutes of the audit committee did not provide sufficient appropriate audit evidence to confirm the following:

40. The audit committee did not advise the accounting officer on matters relating to performance management and performance evaluation, as required by section 166(2)(a) of the MFMA.
41. The audit committee did not advise the accounting officer on matters relating to the adequacy, reliability and accuracy of financial reporting and information, as required by section 166(2)(a)(iv) of the MFMA.
42. The audit committee did not review the annual financial statements to provide the council with an authoritative and credible view of the financial position of the entity, its efficiency and effectiveness and its overall level of compliance with the MFMA, DoRA and other applicable legislation, as required by section 166(2)(b) of the MFMA.

Internal audit

43. The internal audit unit did not audit the results of performance measurements, as required by section 45(1)(a) of the MSA and Municipal Planning and Performance Management Regulation 14(1)(a).
44. The internal audit unit did not assess the functionality of the performance management system, whether the performance management system complied with the requirements of the MSA and the extent to which the performance measurements were reliable in measuring the performance of the municipality on key and general performance indicators, as required by Municipal Planning and Performance Management Regulation 14(1)(b)(i), (ii) and (iii).

Procurement and contract management

45. Goods and services with a transaction value below R200 000 were procured without obtaining the required price quotations, as required by SCM Regulation 17(a) and (c).
46. Quotations were accepted from prospective providers who are not registered on the list of accredited prospective providers and do not meet the listing requirements prescribed by the SCM policy, in contravention of SCM Regulations 16(b) and 17(b).
47. Construction projects were not always registered with the Construction Industry Development Board (CIDB), as required by section 22 of the Construction Industry Development Board Act of South Africa, 2000 (Act No. 38 of 2000) and CIDB Regulation 18.
48. Contracts and quotations were awarded to providers whose tax matters had not been declared

by the South African Revenue Service to be in order, as required by SCM Regulation 43.

49. Contracts and quotations were awarded to bidders who did not submit a declaration on whether they are employed by the state or connected to any person employed by the state, as required by SCM Regulation 13(c).

Expenditure management

50. Sufficient appropriate audit evidence could not be obtained that money owing by the municipality had always been paid within 30 days of receiving an invoice or statement, as required by section 65(2)(e) of the MFMA.
51. The accounting officer did not take reasonable steps to prevent unauthorised and irregular expenditure, as required by section 62(1)(d) of the MFMA.

Conditional grants received

52. Unspent conditional grant funds not committed to identifiable projects and not approved by the National Treasury for retention were not surrendered to the National Revenue Fund, as required by section 20(1) of DoRA.

Revenue management

53. An adequate management, accounting and information system was not in place to recognise revenue when it was earned and to account for debtors, as required by section 64(2)(e) of the MFMA.

Asset management

54. An adequate management, accounting and information system was not in place to account for investment property, as required by section 63(2)(a) of the MFMA.
55. An effective system of internal control for investment property (including an investment property register) was not in place, as required by section 63(2)(c) of the MFMA.
56. All investments were not made in accordance with the requirements of the investment policy, as three written quotations were not obtained from qualifying institutions prior to the investment of municipal funds, as required by Municipal Investment Regulation 3(3).

Liability management

57. A management, accounting and information system was not in place to adequately account for liabilities, as required by section 63(2)(a) of the MFMA.
58. Long-term debt was incurred without a resolution of the municipal council approving the debt agreement, in contravention of section 46(2) of the MFMA.

Internal control

I considered internal control relevant to my audit of the financial statements, performance report and compliance with laws and regulations. The matters reported below under the fundamentals of internal control are limited to the significant deficiencies that resulted in the basis for the qualified opinion, the findings on the performance report and the findings on compliance with laws and regulations included in this report.

Leadership

59. The accounting officer did not exercise oversight responsibility over the preparation of the financial statements, the report on predetermined objectives, compliance with laws and regulations, and internal control. The leadership did not implement processes to ensure that reviews took place before information was submitted. This was also evidenced by the material misstatements in the financial statements, non-compliance with laws and regulations and internal control deficiencies noted throughout the audit process.
60. The accounting officer did not evaluate whether management had implemented effective internal controls by gaining an understanding of how senior management members had met their responsibilities.

Financial and performance management

61. Manual or automated controls were not designed to ensure that the transactions had occurred, were authorised and were completely and accurately processed in all instances, while the system of internal control was not adequately designed. Certain corrective measures were not implemented to address the shortcomings in the financial statements and related systems.
62. The municipality did not have documented and approved internal policies and procedures to address planning, monitoring and reporting processes and events pertaining to performance information.
63. There were deficiencies in the design and implementation of internal control in respect of compliance with applicable laws and regulations.
64. Material amendments had to be made to the financial statements as these were not accurate and complete, because senior management did not pick up inconsistencies during the review process. This indicates that there were weaknesses in internal control with regard to the review process of the financial statements.
65. In the absence of appropriate GRAP training to municipal officers, management appointed external service providers to assist with the compilation of a GRAP-compliant asset register.
66. The SCM unit of the municipality did not function effectively. The necessary procedures were not always followed and SCM officials were not aware of all the acts and regulations that should be adhered to concerning SCM.

Governance

67. The internal audit unit did not have sufficient capacity to perform the required functions. The unit could therefore not promote accountability and service delivery through evaluating and monitoring responses to risks and providing oversight over the effectiveness of the internal control environment, including financial and performance reporting and compliance with laws and regulations.

Kimberley

17 January 2013



AUDITOR-GENERAL
SOUTH AFRICA

Auditing to build public confidence